THE WAR-TAX PARADOX

John Stuart Mill's well known view that war may be paid for twice, each time at the cost of wages, found its basis in the now generally discredited wage-fund analysis. So far, Mill argued, as the funds for war are derived from capital—the revenues for government use obtained not through restrictions of individual expenditure but by deductions from the capital funds devoted to the paying of wages—so far must the wages of labor suffer. These reductions in wages would, therefore, cover the entire cost of the war, were it true that the funds for the war were derived exclusively through deductions from the volume of wage-fund capital. Nor, so far, would it signify whether the funds were secured by taxes or by bond issues, whether the scrap of paper returned by the government were a receipt of acquittance or a promise of indemnity. But with bonds, when the time for retiring them should arrive, the wage earner might be, through taxes, subjected a second time to a burden equaling the entire original cost of the war—no account being made of the intermediate interest charges.

But if the war were paid for twice out of wages, when it had imposed costs only once, to whom would accrue the gains attaching to this doubled payment? On this issue Mill's analysis throws no certain light. Clearly, however, if the restriction of capital funds carried with it a proportionate volume of unemployment, the losses in wages would accrue without any correlative gain to any one. But if the laborers still remained all at work, only at diminishing wages, the losses in wages would be credited to the employers' or the investors' margins; the laborers would stand essentially as the ultimate cost bearers of the war. The investors and the employers would have made a direct contribution of funds only to the extent of their offsetting intake of gains. Indirectly, but essentially, the laborers would be, in the first stage, the indirect but none the less the real and the ultimate contributors. Later, in the process of discharging the bonds, they would make a final settlement of the profits accounts.

If, however, the direct contributors received tax receipts but no bonds, the war would merely have imposed its costs precisely where the "capacity" was lacking, and would have allowed exemption precisely where payment should have been exacted. Neither interest nor profits but only wages would have paid. But if the direct contributors were awarded bonds instead of acquit-

tances—the wage-earners turning over to capital and enterprise a fund of net gain equal in volume to whatever should be the fiscal outlays in financing the war—the situation would be summed up in one war cost and one war profit, both at the charge of labor.

But Mill's analysis pointed to the conclusion that under no credibly possible war conditions was there hope of entire escape from fiscal wrong to the laborers. On them inevitably the war process must impose extreme and unmerited and disproportionate hardships. The best that could be hoped was that the lending class would lend out of their restricted expenditures—oblivious of the fact that this would amount merely to a gratuitous philanthropy on their part; better far to lend out of their wage capital and recoup themselves at the expense of labor. And forthwith it followed that the sole significance of bonds in place of tax receipts was to subject the laborers to the further iniquity of affording a corresponding net gain to the people that were best able to pay but that had actually escaped all payment. But the faults were inherent in the inexorable opaque and impersonal sweep of the war process. Mill, so far as I am aware, never anywhere drew the necessary conclusion—the condemnation of war loans, the correlative preference for taxes. War was merely a bad business anyway.

Mill's intuitive sense of fact was, however, a securer guide than his devices of technical analysis. Despite the defects of the wage-fund doctrine as apparatus of inquiry, he arrived at certain very significant conclusions. His thesis that the laboring classes may come near to paying twice for a war that has cost only once, I take to announce not only a theoretical possibility under assumed conditions but the inevitable outcome of conditions that are both probable and actual.

It is possible, it is indeed almost inevitable, that war imposes losses greatly in excess of anything that the fiscal costs, as represented in taxes or bonds, may report or indicate. But a large degree of unemployment in war time or in any other time through the inadequacy of capital funds is not easily credible. Reductions in output are, however, possible through lack of capital—capital not in the sense of operating funds but only of equipment goods. War must cut into product in the degree that it seriously interferes with the forthcoming or the upkeep of capital goods. This loss, to be sure, is not a tax; rather is it a reduction in the ability

to bear taxes, a partial paralysis of production—product prevented rather than product absorbed. Losses of this sort, however, labor is likely to suffer along with other distributees of industry rather than to bear them exclusively. It is true that the restriction of equipment might serve to make labor the factor relatively plenty and capital goods the factor relatively scarce. In such case, then, wages would receive a diminishing fraction of a diminishing aggregate product; the capital goods, an increasing fraction of a diminishing aggregate.

But with war the facts cannot run after this sort; with great numbers of men changing from industrial to military production or to military service, it is commonly, and almost inevitably, labor rather than equipment that is becoming the relatively scarce factor. A careful distributive analysis will, therefore, not impute to labor any notable share of the war losses which accrue outside the data of fiscal reports. It is, then, by fiscal operations rather than by purely industrial disturbances that the burdens of war are prone to be shifted to laborers or even doubled to the exploitation of laborers.

For it is clear that from the point of view of society as a whole war can impose fiscal costs in only the present tense. Most of the existing body of wealth is not available for any purpose of consumption. It serves only by its contribution to present income, not as itself directly forming a part of present income. Houses, lands, industrial equipment, car lines, are not consumables in any appreciable degree. True, they may wear out and, in the process of depreciation, contribute to current civil or military consumption. The volume of consumable goods remaining over from the past is in any case not great. And most of this volume is destined to early consumption as necessary maintenance, pending the production of newly maturing items of income. No doubt the goods may be stretched somewhat in their period of service beyond their customary term of use. Something of this sort has clearly been accomplished during the recent war months. By wearing our old clothes longer, cobbling old shoes, postponing the purchase of a new overcoat, deferring the renewal of furniture or rugs or tableware, putting off the repapering, we have curtailed our demands on the present national income of goods and services. So, again, there may be cannon and powder and even war bread stored up, as with the Germans in preparation for the war that was to surprise them.

Even so, the direct contributions of accrued wealth to present war consumption are relatively meager. But the contributions of future production are more than meager; they occur not at all. War consumption has no future tense. And still there is a sense in which the burden can be shifted. The people who bear the burden now may be indemnified later at the cost of other people. Such is, in fact, the sole significance of bonds. This contract for later reimbursement finds its occasion in the necessity that present wars provide themselves with present goods and services; only so far can there be present guns or ammunition for battle, or food, or equipment for maintaining the armies. Sir Thomas Browne's pronouncement that "he had caught a great cold had he no other clothes to wear than the skin of a bear not yet killed," goes to the heart of this aspect of the war problem. The enemy cannot be done to defeat or death by future shells discharged from cannon yet to be molded and propelled by powder not yet produced. Only phantom men can wage war with phantom arms or be nourished on future bread. That which, according to the old riddle, is food for dead men and death to living men was accurately unriddled as "nothing"—an ultimate truth for the finances of war. But by borrowing abroad one nation may meet its present needs out of foreign incomes of current product, on terms of the undertaking that out of its own later income of products it will make good the loan of present products from abroad. But this is merely to redistribute the present burden, on terms of a derivative and offsetting redistribution of future incomes. The future does not provide for the war; future producers merely indemnify the present providers. The goods that now go into war will mean a later distribution of goods that will not go into war—and cannot, the war being past.

America, however, in the recent war, having no second America to borrow from, being still, even after its entrance into the war, a great lender to foreign belligerents, had to find at home its present supply of war goods and war services. In the aggregate, then, America had to do more than merely follow the rule of pay-as-you-go. But still it was possible that certain individuals out of the total citizenship should bear the burdens. The necessary transfers of purchasing power out of individual incomes over to the government account for government expenditures, might either be made voluntary, under the inducement of an offered interest-bearing contract, or be made coercive in terms of

taxes. The bond method meant merely present sacrifices out of present incomes in support of the present war on terms of a promised later indemnity out of taxes later to be collected. The tax method meant contributions without a promised indemnity.

It is clear then, that taxes and bonds, so far as they are paid by income receivers out of income receipts, are merely different ways of getting the paying done, so that war activities and war consumption may displace civil activities for civil consumption, and not at all a way of deciding whether the paying shall be done now. With taxes, the contributions are collected, the tale is told, the books closed. The loan method provides that tax payments shall be postponed, not that payment be postponed; that future taxpayers shall indemnify the lenders for their present advances; not that the future shall provide the ships, the coal, the shells, the clothing, the cannon, the food, but that the present furnishers shall in the future be reimbursed through taxes for what they have now advanced. The taxpayer of the future time will merely return to the present contributors (with the addition of interest, it is true) what present taxation would have compelled them to pay now. Taxes are merely postponed and somewhat increased. But the present does not get rid of the burden. The present taxpayer gets rid of it now, only in the sense that the present bond buyer temporarily assumes it.

But note that, at the future date of payment, no cannon will be produced, either to be worn out in war or to be turned back to the lenders or their representatives. They restrict now their present consumption or their alternative investments through turning over their funds to the government for war purchases now. A generation hence some one else must submit to a corresponding restriction of purchasing power, in order that these lenders may have correspondingly larger free resources at that time. War products and war consumption mean a current redistribution of productive power, a functional as well as a personal redistribution. A generation hence is to come another redistribution—not a redistribution of production but only a redistribution of the things produced, a personal distribution solely. The individuals that did not pay in the present, when the things of war were displacing the products of peace, must now assign to the lenders an offsetting share of *the things of peace*. The holders went without civil goods that war goods might be; the taxpayers now go without civil goods in order that the lenders

may have more civil goods. War bonds impose profound modifications upon the distributive institutions of the future time.

So far, then, the issue between bonds and taxes is merely one of equity. Do bonds in their ultimate distribution of sacrifices apportion fairly the burdens of war? The test is in what would be a proper distribution of the costs of war, if war were paid for in current rather than in postponed taxation. If, then, bonds are issued, they should finally be discharged through taxation of precisely the same class incidence as should fairly attach to present taxes. If consumption taxes during war would provide the proper incidence of burdens, the bonds may properly be retired by similar fiscal devices. If, however, the correct basis of apportionment is income, under either proportional or progressive rates, this must also be the correct principle for the taxation that later must meet the interest charges on the bonds and finally provide for their discharge.

But under this program of ultimate settlement there could be neither class pressure nor class advantage with bond issues. The equities would refer merely to the well-to-do in their relations to one another. And in the final settlement the bonds would leave the case exactly as taxes would have left it—the bonds, however, making room for inter-individual preferences with respect to earlier or later final contributions.

So far, therefore, assuming both a present and a future revenue system consistently fair in the apportionment of burdens, there would seem to be small advantage and even smaller disadvantage in the choice between bonds and taxes. But this assumption implies not merely the improbable or the incredible with regard to future tax collections, but also both the incredible and the impossible with regard to the necessary current sacrifices. No great war of even the American sort in the war that is closing, to say nothing of that of the English and the French, can be supported under a distribution of burdens ethically tolerable in time of peace. If a great war is to go on, the burden of it has to be drastically severe on the poor as well as on the rich. Whatever the fiscal forms of collection, a high rate of charge must trench upon even the relatively meager incomes. Only when the masses contribute, and contribute greatly, can the fiscal return be considerable.

Assume, for example, the pre-war level of prices; a national

income of $40,000,000,000; a war budget of $15,000,000,000, approximately two fifths of the current national income. The income tax returns for the year 1914 reported less than 400,000 incomes above $3,000. A 100 per cent income tax on all these incomes, averaged as at $3,000 without even a minimum exemption, would afford less than $1,250,000,000 of revenues. Assume the incomes to have averaged $6,000 each, without exemption—$2,400,000,000 of fiscal returns. Double the incomes as allowance for under-statement—$5,000,000,000 in all. Double the number of income receivers as allowance for evasions—$10,000,000,000. The average family income for our 23,000,000 families, as deduced from the 1916 returns, appears to have been approximately $1800, inclusive of corporate holdings and business gains. Eight hundred thousand families had incomes of upwards of $2500 exclusive of corporate and business gains. The total income of all these 800,000 families (exclusive again of corporate and business holdings averaged at $400 for each of the 27,000,000 families), was $9,750,000,000. Assume now that three fourths of all corporate and business returns accrued to these 800,000 families—$9,000,000,000. A tax then that should take 100 per cent of all these incomes, without exemption of any sort, would provide $19,000,000,000 of revenue out of an estimated total national income of $50,000,000,000. Allowing a $2,000 exemption, the total remaining incomes for the 800,000 families would be approximately $17,000,000,000. At an average tax of 33 per cent on the taxable revenues the yield would be less than $6,000,000,000. At the actual rates as they were imposed for the year 1916 the yield of all income, corporate and profits taxes was $345,000,000; for 1917, $3,000,000,000.

Quite obviously, then, a war absorbing two fifths of the current national resources of goods and services is possible only on terms of great sacrifices imposed on the relatively meager incomes. After the rich and the well-to-do have paid all that they can, there is still an enormous payment necessary from the masses. A great war calls on all for all that they can spare. The income tax returns for 1914 showed only one $3,000 income out of seventy families. It is safe to say that to nineteen men out of twenty belongs the vague word *poor;* they are artisans, wage-earners, laborers. The support of a great war requires their grievous contributions.

Somehow, therefore, the masses of citizens must and do contribute to a great war. When the average income for civil consumption falls by two fifths, the incomes of the masses must fall. Real wages in the average must suffer relatively to product, precisely because two fifths of the national product is being diverted from civil consumption. The average income must suffer quantitatively also, unless it be true that the efficiency of civil production is so speeded up as to offset not only all the displacement of men and of capital and of civil production, but also whatever degree of rapid consumption is peculiar to the new war activities—shipping, coal, oil, munitions, ammunition, motor cars, strategic railroads, warehouses—and finally also the amount by which the consumption of food and apparel is exceptionally large. That the per capita expenditure in civil consumption declines relatively to the per capita product, rests in the mathematical necessities of the case. And that the per capita civil consumption must decline in quantitative command of goods is practically clear. Out of short crops an unusually large amount was exported. Iron was scant for civil consumption, also leather, fuel, woolens, and perhaps especially, cotton. This scarcity was indeed established by the very fact that old things were made to do duty in place of new, purchases being deferred in countless lines. This restriction of consumption, and measurably also of new construction, was the means by which ultimately the sacrifices of war were borne. There is little evidence that the per diem output of labor was appreciably increased, a very considerable body of evidence to the contrary. There has been much deliberate waste of time in a wide range of industries. And the very fact of a widespread redistribution of laborers into novel occupations involves the cancellation of much specialized skill. The new economic activities of women counted for disappointingly and shamefully small results in the total. Whatever, therefore, the technical form of payment, the income of laborers had to suffer. The actual rate approached the charge upon the most princely of American incomes; the general rise of prices has far outstripped the general rise of wages. In this lag of real wages was the laborers' contribution. There is slight prospect of such rates in future income taxes for the retirement of the war bonds as shall offset the abnormal apportionment of burdens under the present methods. More probable is it that the future taxes will be more distinctly regressive, relatively to paying capacity, than are the present methods.

Thus far, then, Mill's dissatisfaction with the distribution of the fiscal and other hardships of war appears to have been based either on the erroneous assumption that the injustices are inevitable or that they inhere in bad systems of taxation. In actual fact, however, the hardships of war have further aspects. Ordinarily there are price disturbances due to inflation. And ordinarily there is conscription. The addition of either of these factors profoundly modifies the problem.

Conscription means for the individual who is conscripted a 100 per cent levy on his assets as a going concern—his connections, his job, a practically complete appropriation of his wages, the possible requirement of his life. My conscripted colleague—whose salary was suspended, his position set at hazard, his wife sent back to teaching—returns to pay me interest on my investment in war bonds. Relatively to his, my sacrifice would have been all too little if, with twenty-fold my actual contribution, all of it had been taxes. Suppose, for example, that he and I had been adjoining farmers, bordering on a swamp and forest area out of which, on occasion, some dangerous marauding animal came to devastate our crops. Let it be arranged between us that he, as the younger and physically the more valid individual at the same time being the less well-to-do, shall devote the season to hunting down and destroying the marauder. Meanwhile his crop is to go unmade, his farm to deteriorate, his health probably to be impaired, his life possibly to be forfeited. He must have maintenance during his service in the joint interest. I am to "stake" him; but it is on the understanding that if he survives to return, he must reimburse me for my advances. If not, his children shall.

This illustration falls short of adequacy only in assuming that my colleague has acquiesced in my consistently patriotic plan of loan finance; and yet conscription was in waiting had he demurred at the obviously businesslike arrangement.

But with inflation as an integral feature of our loan finance, there arises the necessity of modifying the illustration. Assume now that, in providing the maintenance to which I bind myself, I plan to reinforce my income rather than to make any net encroachment on it, or any derivative reduction in my scale of living. The burden imposed on me by the summer activities of my expeditionary neighbor I am to make good through cutting timber off my neighbor's woodlot, so that when he gets back, or whether or not he gets back at all, I shall be none the poorer by

my maintenance of him and shall be so much the richer by my bonds—bonds that, by some necromancy or financial mystery, I hold against him instead of his holding them against me.

No? But this is precisely what inflation finance means. All the while the argument must, of course, be taken to apply solely to that share of the war revenues that is obtained through bonds. Assume also—as may be actual—that the volume of bonds is not greater than the war profits; and assume also—for clarity, since classwise it does not matter—that all the subscriptions to bonds are paid for out of war profits. The causes of the inflation, as it actually occurs, and the mechanism of the process in its ordinary actual working, are best omitted from present consideration; they complicate the analysis without further essential bearing on the argument. If, then, we assume an inflation as already well under way, a situation will be presented illustrating Mill's pessimistic foreboding at its extreme limit.

Inevitably in inflation periods employers' margins widen. This means that real wages fall. They may rise in terms of money units, but the money is weazening out in terms of exchange power. The currency unit is getting cheap because currency units are getting plenty. Money wages are derivative from the prices of products. When prices rise money wages will therefore shortly set toward rise as the result of employers' competitions. But costs lag behind prices, wages among the rest. This lag in money costs is the explanation of the increasing margins of money profits. Profits are increasing at the expense of wages. When prices are rising, employers compete against one another in order to get the advantage of these widening margins of gain that the selling prices offer. This competition pushes money wages up. With time enough, if general prices stop rising, this competitive bidding up of money wages will finally cancel exceptional margins; wages will catch up with prices and profits.

But during this period of readjustment real wages suffer. In terms not of money units but of what the money units will buy the wages go not up but down. This is only another way of saying that wages lag behind prices, another way of saying also that profits are more generous. It is not, to be sure, impossible that during the inflation years there may be certain wage advances that are real; but in general they are not so. If, indeed, the advances were real and general, the profits so far could not be actual. In those industries also in which, as in recent years, real wages

have been rising, it is safe to say that the profit margins have risen still faster.

These inflation-made margins of war years are not accurately war margins so much as inflation margins. Either with or without the war the inflation would award the same general range of profits, though clearly not quite the same peculiar distribution of them. Inflation is, in truth, about as effective a method of fleecing wage-earners as of expropriating creditors.

The special function of inflation as a device of war finance is, then, clear. In one way or another in war time real wages have to suffer. There must be either falling net money wages with stable general prices, or stable or rising money wages with a more than offsetting general rise in commodity prices. The consumption of goods and services with the wage-earning masses must be restricted, else the war, with its enormous requirements in the absorption of man power and in the displacement of civil consumption, cannot go on. The per capita consumption of goods for civil consumption being less, and the producers of them fewer, as the war absorption and consumption are more, the average civil consumption has to be less. Real wages report simply the command over consumable goods, buying power. When there is a shortage of things to buy, there must be a shortage in buying power—less money income per capita or less buying power in the same number of money units, rising prices. In America nearly 4,000,000 of men have been conscripted into service abroad or into preparation in the training camps. Other millions have been withdrawn from the industries ministering to civil consumption and diverted into shipping, new supply industries, munitions and armament. It is even asserted that 18,000,000 to 20,000,000 out of our 40,000,000 of bread-winners have been engaged directly or indirectly in war production, one half the productive energies of the country—to my mind a gross exaggeration. But still the facts had to mean a greatly restricted civil consumption. The wage-earners and their dependents include the mass of any population. Unless, then, they saved in order to lend, or were taxed into low net real wages (restricted consumption), they had to be profiteered into low real wages and restricted consumption. The country had to have their restricted consumption.

They were profiteered. (Remember all the while that it is only one aspect of war finance, taken for clarity as the sole aspect, that is under present analysis.) It was in terms of increasing

profits that wages were restricted, the prices rising faster than the money wages. From the employer's viewpoint, this meant that the things he had to sell rose faster than the wages he had to pay. This increasing spread between costs and selling prices constituted profits. Viewed from the laborer's angle, this meant declining real wages. Half understanding and wholly patriotic the wage-earner submitted.

But, understanding better, he could hardly have done less. In the absence of increased charges through excises and customs, this was his way of bearing war burdens. It was his tax. Something of this sort, by this device or by another, there had to be. Only, therefore, when viewed in its relation to a total need and in comparison with the burdens that other tax-paying ability was bearing, could any issue of justice remain with reference to the stay-at-home laborers. But were other incomes subjected to their relatively due burdens? I think not. But different interpretations of the statistical facts and different readings of the precepts of justice in taxation, may leave differences of opinion possible.

But what about the profits and the taxes on them—directly as technical profits taxes or indirectly as income taxes? Precisely here is the crux of the problem, precisely here the practical significance of the *business-as-usual* plea. The profit makers were the government collectors of a contribution from labor that in this or in some other form was imperative and inevitable. The laborers were paying—as Mill had inferred, though deducing it from an untenable analysis—but were paying in terms of employers' margins, the wage lag a contribution to profits, at the same time with a reduction in real wages and a restricted spending power.

But what were the collectors doing with the collections?, With good profits they could buy many bonds. Not paying taxes with their profits, buying bonds was the most patriotic thing they could do. Their preference was for receiving interest-bearing promises, rather than non-interest-bearing tax acquittances. In the main, their purchases of bonds were taken as an acceptable settlement with the fisc. Mill's prophetic foreboding that labor, having paid once for the war, must now pay a second time to those lending for the war, was in the fatal way of fulfilment. The bonds that had been purchased out of the margins contributed by labor were now a valid obligation against the laborer as taxpayer.

Only through a special and radical and incredible and almost impracticable adaptation of the future tax system to the new situation could any remedy come. As much as, during the war, the laborers had lost through war the employers had gained and invested; and now the employers would collect it again. Out of the impoverishment of the resources of my neighboring farmer I had derived the funds in support of him in his dangerous undertaking for our joint advantage; and now he was under obligation to pay me again.

But, be it again repeated, the harm was not that the real wages were low, for they had to be, if there was to be a war; not that the masses had to suffer, for there was no other way if the war was to go on; not, finally, that the laborers did not get the bonds in place of the profit makers, for future taxes must be high enough at best; but the harm was that anybody got any bonds—bonds on which someone in the future must be taxed to meet the interest charges and finally also to discharge the principal.

Nor was it by the fact that the prices were high that there was injustice, nor even by the fact that the prices which were rising faster than the wages, made possible the profits—if only it had been true that the government which had allowed the collection of the profits had absorbed them in taxes. It was in the wrong sort of settlement with the collectors, in the giving to them of bonds instead of receipts in full, that the harm lay. Not only must the laborer bear a great share of the war burden during the war, but he must face his burden of taxes after the war is finished. The one burden, the current burden, was inevitable. It should have been the sole burden. But after all, it was not a willful wrong; only tragic blundering.

Peace, then, to Mill's prophetic spirit—possibly, also, a sad sort of joy that now our bungling world of idealism and practical business has actualized his puzzling paradox. But will the socialists and the other radicals and agitators allow to the rest of us peace?

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